SERVICESOURCE INTERNATIONAL, INC.
Form 10-Q
May 13, 2011
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UNITED STATES

SECURITIES AND EXCHANGE COMMISSION

Washington, D.C. 20549

FORM 10-Q

(Mark One)

x **QUARTERLY REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the quarterly period ended March 31, 2011

OR

¨ **TRANSITION REPORT PURSUANT TO SECTION 13 OR 15(d) OF THE SECURITIES EXCHANGE ACT OF 1934**

For the transition period from to

Commission file number 001-35108

SERVICESOURCE INTERNATIONAL, INC.

(Exact name of registrant as specified in our charter)

Delaware	**No. 81-0578975**
(State or Other Jurisdiction of Incorporation or Organization)	**(I.R.S. Employer Identification No.)**
634 Second Street San Francisco, California	**94107**
(Address of Principal Executive Offices)	**(Zip Code)**

(415) 901-6030

(Registrant s Telephone Number, Including Area Code)

Indicate by check mark whether the registrant (1) has filed all reports required to be filed by Section 13 or 15(d) of the Securities Exchange Act of 1934 during the preceding 12 months (or for such shorter period that the registrant was required to file such reports), and (2) has been subject to such filing requirements for the past 90 days. Yes ¨ No x

Indicate by check mark whether the registrant has submitted electronically and posted on its corporate Web site, if any, every Interactive Data File required to be submitted and posted pursuant to Rule 405 of Regulation S-T during the preceding 12 months (or for such shorter period that the registrant was required to submit and post such files). Yes ¨ No ¨

Indicate by check mark whether the registrant is a large accelerated filer, an accelerated filer, a non-accelerated filer or a smaller reporting company. See the definitions of large accelerated filer, accelerated filer and smaller reporting company in Rule 12b-2 of the Exchange Act. (Check one):

Large accelerated filer ¨	Accelerated filer ¨
Non-accelerated filer x (Do not check if a smaller reporting company)	Smaller reporting company ¨

Indicate by check mark whether the registrant is a shell company (as defined in Rule 12b-2 of the Exchange Act). Yes ¨ No x

Indicate number of shares outstanding of each of the issuer s classes of common stock, as of the latest practical date:

Class	**Outstanding as of May 09, 2011**
Common Stock	67,523,365

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PART I FINANCIAL INFORMATION

Item 1. ***Financial Statements***

SERVICESOURCE INTERNATIONAL, INC.

CONDENSED CONSOLIDATED BALANCE SHEETS

(In thousands)

(Unaudited)

	December 31, March 31, 2011		December 31, December 31, 2010	
Assets				
Current assets:				
Cash	$	73,883	$	22,652
Accounts receivable, net		42,867		49,237
Advances to customers				18
Current portion of deferred income taxes		5,712		1,155
Prepaid expenses and other		3,238		3,326
Total current assets		125,700		76,388
Property and equipment, net		19,664		19,418
Goodwill		6,334		6,334
Deferred debt issuance costs, net		303		273
Deferred income taxes, net of current portion		27,658		3,780
Other assets, net		1,620		1,910
Total assets	$	181,279	$	108,103
Liabilities and Stockholders / Members Equity				
Current liabilities:				
Accounts payable	$	4,657	$	3,710
Accrued taxes		3,458		2,233
Accrued compensation and benefits		12,717		11,816
Accrued payables to customers				30,640
Other accrued liabilities		7,890		7,575
Current portion of long-term debt		640		2,279
Total current liabilities		29,362		58,253
Long-term debt, net of current portion		999		14,939
Other long-term liabilities		1,153		1,027
Total liabilities		31,514		74,219
Commitments and contingencies (Note 5)				
Stockholders / members equity:				
Common shares				34,161
Common stock		7		
Treasury shares / stock		(441)		(441)
Additional paid-in capital		127,961		

Retained earnings	21,721	
Accumulated other comprehensive income	517	164
Total stockholders / members equity	149,765	33,884
Total liabilities and stockholders / members equity	$ 181,279	$ 108,103

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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SERVICESOURCE INTERNATIONAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF OPERATIONS

(In thousands, except per share amounts)

(Unaudited)

	Three Months Ended March 31,	
	2011	2010
Net revenue	$ 46,122	$ 32,176
Cost of revenue	26,136	20,771
Gross profit	19,986	11,405
Operating expenses		
Sales and marketing	11,105	7,604
Research and development	2,713	1,018
General and administrative	7,853	3,970
Total operating expenses	21,671	12,592
Loss from operations	(1,685)	(1,187)
Interest expense	(333)	(311)
Other expense, net	(525)	(95)
Loss before income taxes	(2,543)	(1,593)
Income tax (benefit) provision	(19,959)	177
Net income (loss)	$ 17,416	$ (1,770)
Net income (loss) per common share:		
Basic	$ 0.30	$ (0.03)
Diluted	0.28	$ (0.03)
Weighted-average shares used in computing net income (loss) per common share:		
Basic	57,797	56,884
Diluted	63,096	56,884

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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SERVICESOURCE INTERNATIONAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CHANGES IN STOCKHOLDERS / MEMBERS EQUITY AND COMPREHENSIVE INCOME

(In thousands)

(Unaudited)

	Common Shares		Common Stock		Treasury Shares/Stock		Additional Paid-in Capital	Retained Earnings	Accumulated Other Comprehensive Income	Total
	Shares	Amount	Shares	Amount	Shares	Amount				
Balances, December 31, 2010	57,627	$ 34,161		$	(121)	$ (441)	$	$	$ 164	$ 33,884
Issuance of common stock in connection with initial public offering, net of issuance costs of $10,181			9,791	1			87,728			87,729
Issuance of common stock from exercise of stock options	133	476								476
Stock-based compensation		2,241					205			2,446
Excess tax benefits from exercise of stock options							23			23
Comprehensive income:										
Net income		(4,305)						21,721		17,416
Foreign currency translation adjustments									353	353
Total comprehensive income										17,769
Conversion to corporation (Notes 1 and 6)	(57,760)	(32,573)	57,760	6			40,005			7,438
Balances, March 31, 2011		$	67,551	$ 7	(121)	$ (441)	$ 127,961	$ 21,721	$ 517	$ 149,765

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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SERVICESOURCE INTERNATIONAL, INC.

CONDENSED CONSOLIDATED STATEMENTS OF CASH FLOWS

(In thousands)

(Unaudited)

	Three Months Ended March 31, 2011	2010
Cash flows from operating activities		
Net income (loss)	$ 17,416	$ (1,770)
Adjustments to reconcile net income (loss) to net cash (used in) provided by operating activities:		
Depreciation and amortization	1,945	1,371
Amortization of deferred financing costs	171	36
Deferred income taxes	(20,975)	(249)
Stock-based compensation	2,446	1,971
Tax benefit from stock-based compensation	(23)	
Changes in operating assets and liabilities:		
Accounts receivable	6,370	(2,949)
Advances to customers	18	366
Prepaid expenses and other	(1,082)	(577)
Accounts payable	254	661
Accrued taxes	1,225	399
Accrued compensation and benefits	901	46
Accrued payables to customers	(30,640)	3,695
Other accrued liabilities	481	1,759
Net cash (used in) provided by operating activities	(21,493)	4,759
Cash flows from investing activities		
Acquisition of property and equipment	(2,757)	(1,411)
Cash used in investing activities	(2,757)	(1,411)
Cash flows from financing activities		
Net proceeds from issuance of common stock in initial public offering	90,330	
Proceeds from revolving credit facility	23,424	
Repayment of revolving credit facility	(23,424)	
Repayment on long-term debt	(15,579)	(314)
Payment of deferred debt issuance costs	(200)	
Cash distributions to members		(2,517)
Proceeds from option exercises	476	271
Repurchases of common shares		(206)
Tax benefit from stock-based compensation	23	
Net cash provided by (used in) financing activities	75,050	(2,766)
Net increase in cash	50,800	582
Effect of exchange rate changes on cash	431	(39)
Cash at beginning of period	22,652	13,169

Cash at end of period	$ 73,883	$ 13,712

The accompanying notes are an integral part of these Condensed Consolidated Financial Statements.

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NOTES TO UNAUDITED CONDENSED CONSOLIDATED FINANCIAL STATEMENTS

Note 1 Description of Business and Basis of Presentation

On March 24, 2011, ServiceSource International LLC, a Delaware limited liability company, (the LLC) converted into a Delaware corporation and changed its name from ServiceSource International LLC to ServiceSource International, Inc. (the Company or ServiceSource). In connection with this conversion, all of the outstanding common shares representing members equity automatically converted into shares of common stock.

On March 30, 2011, the Company closed its initial public offering (IPO) of 13,731,153 shares of its common stock, which included 9,791,020 shares of common stock sold by the Company (inclusive of 1,791,020 shares of common stock from the full exercise of the over-allotment option of shares granted to the underwriters) and 3,940,133 shares of common stock sold by the selling stockholders. The public offering price of the shares sold in the offering was $10.00 per share. The Company did not receive any proceeds from the sales of shares by the selling stockholders. The total gross proceeds from the offering to the Company were $97.9 million. After deducting underwriting discounts and commissions and offering expenses payable by the Company, the aggregate net proceeds received by the Company totaled approximately $87.7 million. As of March 31, 2011, $2.6 million of offering costs remained unpaid and these costs are expected to be paid in the Company s second fiscal quarter.

ServiceSource International, Inc manages the service contract renewals process of maintenance, support and subscription agreements on behalf of its customers. The Company s integrated solution consists of a suite of cloud applications, dedicated service sales teams working under its customers brands and a proprietary Service Revenue Intelligence Platform. By integrating software, managed services and data, the Company provides end-to-end management and optimization of the service contract renewals process, including data management, quoting, selling and service revenue business intelligence. The Company s business is built on a pay-for-performance model, whereby customers pay the Company based on renewal sales that the Company generates on the customers behalf. The Company s corporate headquarters are located in San Francisco, California. The Company has additional offices in Colorado and Tennessee in the U.S., the United Kingdom, Ireland, Malaysia and Singapore.

The accompanying unaudited Condensed Consolidated Financial Statements have been prepared in accordance with generally accepted accounting principles in the United States of America (GAAP) for interim financial information. Accordingly, they do not include all of the information and footnotes required by GAAP for complete financial statements. Therefore, these statements should be read in conjunction with the audited Consolidated Financial Statements and Notes thereto for the year ended December 31, 2010, included in our prospectus, dated March 24, 2011, filed pursuant to Rule 424(b)(4) under the Securities Act with the Securities and Exchange Commission. The condensed consolidated balance sheet as of December 31, 2010 included herein was derived from the audited financial statements as of that date, but does not include all disclosures including notes required by GAAP. In the opinion of management, the accompanying unaudited Condensed Consolidated Financial Statements reflect all adjustments necessary to present fairly the financial position, results of operations, and cash flows for the interim periods, but are not necessarily indicative of the results of operations to be anticipated for 2011.

Certain amounts in the financial statements for the prior periods have been reclassified to conform to the current presentation. These reclassifications did not change the previously reported net loss, net change in cash and cash equivalents or stockholders / members equity.

Recently Adopted Accounting Pronouncements

In October 2009, Financial Accounting Standards Board (FASB) amended the accounting standards for multiple- deliverable revenue arrangements to:

(i) provide updated guidance on whether multiple deliverables exist, how the deliverables in an arrangement should be separated, and how the consideration should be allocated;

(ii) require an entity to allocate revenue in an arrangement using best estimated selling prices (BESP) of deliverables if a vendor does not have vendor-specific objective evidence of selling price (VSOE) or third-party evidence of selling price (TPE); and

(iii) eliminate the use of the residual method and require an entity to allocate revenue using the relative selling price method. This standard was effective for the Company beginning January 1, 2011.

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The Company s revenues are primarily derived from sales of service contracts and account management services, which are contingent in nature as commissions are earned only based on successful performance of the related services, and are affected by a number of engagement-specific factors not within the Company s control. These fees are all contingent based on the Company s customers end customers and their willingness to purchase the maintenance contract renewals and whether the Company s customers accept the order from their end customer. Because commissions earned from these services are contingent, are based on a formula stipulated in the contract and are negotiated uniquely based on the specific factors of each specific engagement, the Company determined that the updated accounting standard is not applicable to these contingent revenue streams currently under contract. Sales of service contracts and account management services are excluded from the allocation of relative selling prices at the inception of the Company s multiple-deliverable arrangements.

The Company had a very limited number of multiple-deliverable arrangements prior to January 1, 2011, and the Company has not had any materially modified transactions from these limited multiple-deliverable arrangements subsequent to January 1, 2011. As such, the impact from the adoption of the new accounting standard was not significant.

Note 2 Property and Equipment, Net

Property and equipment balances were comprised of the following (in thousands):

	March 31, 2011 (unaudited)	December 31, 2010
Computers and equipment	$ 8,429	$ 7,765
Software	17,785	13,169
Furniture and fixtures	5,552	5,503
Leasehold improvements	3,074	2,898
	34,840	29,335
Less: accumulated depreciation and amortization	(15,984)	(13,960)
	18,856	15,375
Internal-use software development in process	808	4,043
	$ 19,664	$ 19,418

Depreciation expense related to property and equipment, including amortization of assets held under capital leases of $0.2 million and $0.1 million, was $1.9 million and $1.4 million during the three months ended March 31, 2011 and 2010, respectively. Property and equipment with a carrying value of $1.9 million and $2.0 million, net of accumulated amortization of $1.3 million and $1.1 million, were held under capital leases at March 31, 2011 and December 31, 2010, respectively.

The Company capitalized internal-use software development costs of $1.3 million and $1.1 million during the three months ended March 31, 2011 and December 31, 2010, respectively. As of March 31, 2011 and December, 31 2010, the carrying value of capitalized costs related to internal-use software, net of accumulated amortization, was $8.2 million and $4.4 million, respectively. Amortization of capitalized costs related to internal-use software was $0.8 million and $0.6 million during the three months ended March 31, 2011 and December 31, 2010, respectively.

Note 3 Other Accrued Liabilities and Accrued Payables to Customers

Other accrued liabilities balances were comprised of the following (in thousands):

	March 31, 2011	December 31, 2010

	(unaudited)	
Amounts refundable to end customers	$ 1,967	$ 2,083
Accrued professional fees	1,558	2,485
Deferred revenue	137	151
Deferred rent obligations	714	477
Employee reimbursements	395	353
Other	3,119	2,026
	$ 7,890	$ 7,575

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Accrued Payable to Customers

For a limited number of historical customer arrangements that included both sales of customer service contracts and other payment collection and account management services, the Company recorded advances to and accrued payables to customers to account for the timing differences between when the Company collected cash from end customers and when it made payments to its customers. The accrued payable to customers balance at December 31, 2010 consisted primarily of net payments due to Sun Microsystems, Inc. from end customers renewing their service contracts with Sun Microsystems through the company. Oracle terminated the Company s contracts with Sun Microsystems effective as of September 30, 2010. In the first quarter of 2011, the Company repaid amounts it owed to Sun Microsystems, net of amounts Oracle owed to the Company, resulting in net cash payments to Oracle/Sun of approximately $18.1 million which were funded from existing cash and borrowings under a revolving credit facility. The Company recognized $1.8 million in additional net revenue in the quarter ended March 31, 2011 resulting from this settlement.

Note 4 Long Term Debt

Long-term debt balances were comprised of the following (in thousands):

	March 31, 2011 (unaudited)	December 31, 2010
Current:		
Term loan	$	$ 1,500
Capital lease obligations	640	779
	640	2,279
Non-current:		
Term loan		13,959
Capital lease obligations	999	980
	999	14,939
Total long-term debt	$ 1,639	$ 17,218

Term Loan and Revolving Credit Facility

As of December 31, 2010, the Company had a credit facility (the Credit Facility), that provided for (i) a $20.0 million term loan and (ii) a $7.5 million revolving credit facility consisting of direct loans, standby letters of credit and trade letters of credit. The Credit Facility was due to expire in April 2013, and was collateralized by substantially all of the Company s assets. At December 31, 2010, there was no outstanding balance on the revolving credit facility and $5.9 million was available for borrowing under the revolving credit facility. The Company also had an outstanding letter of credit of $1.6 million as required under an operating lease agreement for office space as of December 31, 2010. In December 2010, the Company amended its fee arrangement with the Credit Facility lenders such that upon the termination of or prepayment in full of the obligations under the Credit Facility on or prior to December 31, 2011, the Company would be subject to a prepayment premium of 0.5% on the sum of the maximum revolver amount, as defined, and the then-outstanding principal balance on the term loan.

In January 2011 the Credit Facility was amended to (i) increase the maximum commitment amount under the revolving credit facility from $7.5 million to $12.5 million, (ii) eliminate the fixed charge coverage ratio test for the twelve month period ending March 31, 2011 only, (iii) require the Company to maintain a minimum liquidity level of $10 million based on unrestricted cash balances held in the U.S. and available borrowings under the revolving credit facility, as defined therein, from and after May 15, 2011, and (iv) allow for the planned conversion of the LLC to a taxable corporation, initial public offering of the Company s stock and other specified transactions related to the Company.

On February 24, 2011, the Company entered into the Second Amended and Restated Credit Agreement (the New Revolver) with two financial institutions that replaced the Credit Facility and prior amendments and increased the revolving credit facility from $15.0 million to $30.0 million. The New Revolver also retired the term loan under the Credit Facility, without any prepayment premium, and converted such balances to a balance outstanding under a new revolving credit facility. In connection with the prepayment of the Credit Facility, the Company recognized a loss on extinguishment of debt totaling $0.1 million related to the write-off of unamortized debt issuance costs. The loss on extinguishment of debt was recorded as other income (expense), net in the Condensed Consolidated Statements of Operations. In connection with the refinancing, the Company capitalized $0.2 million of deferred debt issuance costs on the Condensed Consolidated Balance Sheets, which are being amortized on a straight-line basis over the remaining term of the New Revolver.

Balances outstanding on the New Revolver are collateralized by substantially all of the Company s assets. The New Revolver provides letters of credit for the account of the Company up to a maximum of $5.0 million. Outstanding letters of credit reduce the maximum available borrowing under the New Revolver. The New Revolver expires on February 25, 2013.

Borrowings on the New Revolver, including amounts outstanding under letter of credit, bear interest at either: (i) the LIBOR Rate plus an additional margin; or (ii) the Base Rate (i.e., prime rate) plus an additional margin. The additional margin is determined based on the Company s financial leverage ratio. On March 30, 2011, net proceeds from the IPO were used to repay $23.4 million borrowed under the New Revolver. At March 31, 2011, borrowings under the New Revolver consisted of a letter of credit in the amount of $1.6 million.

The New Revolver provides for a non-use fee of 0.50% per annum based on the average monthly available borrowing base and a fee on the unused portion of the letter of credit commitment, accruing at a rate per annum ranging from 3.00% to 3.75% based on the Company s leverage ratio and whether the Company has consummated an initial public offering of its shares.

The Company has the option to reduce the maximum New Revolver commitment. Each reduction must be in an amount not less than $5.0 million and in aggregate not more than $10.0 million. Once reduced, commitments under the New Revolver cannot be increased. Reductions will be permitted only within 90 days after the consummation of an initial public offering of the Company s stock. In April 2011, the Company reduced its maximum borrowing under the New Revolver to $20.0 million, effective May 1, 2011. The lenders also have the option to reduce the commitment under the New Revolver in the event a contract with a customer who represented 15% of revenue for any consecutive twelve-month period is terminated or in the event of a series of customer contract terminations, which in the aggregate represented more than 20% of consolidated revenues for the most recent twelve-month period. Under these circumstances, the lenders would have the discretion to reduce the commitment under the New Revolver by the aggregate amount of termination fees received that are related to the cancelled contracts. The New Revolver can be terminated by the Company and is subject to a fee if terminated on or before February 24, 2013 equal to 1.0% of the maximum revolver commitment in effect on the date of termination.

The New Revolver has various restrictive financial covenants, which include maintaining minimum fixed charge coverage and liquidity ratios as well as a maximum consolidated leverage ratio. The New Revolver also contains restrictions on additional indebtedness and, subject to certain exceptions, circumstances under which the Company can make a distribution to its members. Distributions to fund tax obligations of members are permitted so long as there are no events of default, including those related to compliance with financial covenants, immediately prior to or after giving effect to any such distributions. Distributions other than those to fund members tax obligations are subject to the Company achieving specified levels of earnings before interest, taxes, depreciation and amortization or maintaining minimum levels of cash, as defined in the New Revolver. At March 31, 2011, the Company was in compliance with all borrowing covenants.

Capital Leases

The Company has capital lease agreements that are collateralized by the underlying property and equipment and expire through September 2019. The weighted-average imputed interest rates for the capital lease agreements were 5.6% and 2.86 % at March 31, 2011 and 2010, respectively.

The maturities of capital lease obligations as of March 31, 2011 were as follows (in thousands):

Years Ending December 31,	**March 31, 2011** (unaudited)
2011 (remaining nine months)	$ 640
2012	479
2013	75
2014	77
2015	79
Thereafter	289
	$ 1,639

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Note 5 Commitments and Contingencies

Operating Leases

The Company leases its office space and certain equipment under noncancelable operating lease agreements with various expiration dates through August 2018. Rent expense for the three months ended March 31, 2011 and 2010 was $1.5 million and $1.1 million, respectively. The Company recognizes rent expense on a straight-line basis over the lease period and accrues for rent expense incurred but not paid.

Future annual minimum lease payments under all noncancelable operating leases as of March 31, 2011 were as follows (in thousands):

Years Ending December 31,	March 31, 2011 (unaudited)
2011 (remaining nine months).	$ 4,916
2012	6,519
2013	5,108
2014	4,246
2015	2,695
Thereafter	3,273
	$ 26,757

Other Matters

The Company may be subject to litigation or other claims in the normal course of business. In the opinion of management, the Company s ultimate liability, if any, related to any currently pending or threatened litigation or claims would not materially affect its consolidated financial position, results of operations or cash flows.

Note 6 Stockholders Equity

On March, 25, 2011, the Company sold 9,791,020 shares of newly-issued common stock in the IPO, raising net proceeds of approximately $87.7 million, after deducting the underwriting discount and costs incurred related to the IPO.

In conjunction with the conversion from a limited liability company to a Delaware corporation described in Note 1, the Company s certificate of incorporation authorized 1,000,000,000 shares of $0.0001 par value common stock and 20,000,000 shares of $0.0001 par value preferred stock. No preferred stock was issued or outstanding as of March 31, 2011. Further, effective March 1, 2011, the Company became taxable as a corporation rather than as a partnership.

Note 7 Stock-Based Compensation

Stock Option Plans

The Company has granted options through two approved plans, the Company s 2004 Omnibus Share Plan and the 2008 Share Option Plan (collectively, the 2004 and 2008 Option Plans). Concurrent with the effectiveness of our registration statement on Form S-1 on March 24, 2011 (see Note 1), the Company s 2011 Equity Incentive Plan (the 2011 Plan) became effective and all remaining common stock reserved for future grant or issuance under the 2004 Omnibus Share Plan and the 2008 Share Option Plan were added to the 2011 Plan. Shares of common stock reserved for issuance under the 2011 Plan consist of (a) 5,760,000 shares of common stock initially available for future grants under the 2011 Plan plus (b) 2,584,015 shares of common stock previously reserved but unissued under the 2004 and 2008 Option Plans that are now available for issuance under the 2011 Plan. To the extent outstanding awards under the 2004 and 2008 Option Plans are forfeited or lapse unexercised and would otherwise have been returned to the share reserves under the 2004 and 2008 Option Plans, the shares of common stock subject to such awards instead will be available for future issuance under the 2011 Plan. The Company s board of directors administers the 2011 Plan and has authority to determine the directors, officers, employees and consultants to whom options or restricted stock may be granted, the option price or restricted stock purchase price, the timing of when each share is exercisable and the duration of the exercise period and the nature of any restrictions or vesting periods applicable to an option or restricted stock grant.

Under the 2011 Plan, options granted are generally subject to a four-year vesting period whereby options become 25% vested after a one-year period and then vest monthly through the end of the vesting period. Vested options may be exercised up to ten years from the vesting commencement date, as defined in the 2011 Option Plan. Vested but unexercised options expire three months after termination of employment with the Company.

The Company has elected to recognize the compensation cost of all stock-based awards on a straight-line basis over the vesting period of the award. Further, the Company applied an estimated forfeiture rate to unvested awards when computing the share compensation expenses. The Company estimated the forfeiture rate for unvested awards based on its historical experience on employee turnover behavior and other factors.

Determining Fair Value of Stock Options

The Company estimates the fair value of stock option awards at the date of grant using the Black-Scholes option-pricing model. Options are granted with an exercise price equal to the fair value of the common stock as of the date of grant. Compensation expense is amortized net of estimated forfeitures on a straight-line basis over the requisite service period of the options, which is generally four years.

The weighted average Black-Scholes model assumptions for the three months ended March 31, 2011 and 2010 were as follows:

	Three Months Ended March 31,	
	2011	**2010**
	(unaudited)	
Expected term (in years)	5.4	5.4
Expected volatility	54%	54%
Risk-free interest rate	2.33%	2.32%
Expected dividend yield		

Option and restricted stock activity under the 2011 Plan for the three months ended March 31, 2011 were as follows: (shares in thousands):

		Options Outstanding		Restricted Stock Outstanding	
	Shares and Units Available for Grant	**Number of Shares**	**Weighted-Average Exercise Price**	**Number of Shares**	**Weighted-Average Exercise Price**
Outstanding December 31, 2010	2,871	17,723	$ 4.32		
Additional shares reserved under the 2011 equity incentive plan (unaudited)	5,760				
Granted (unaudited)	(611)	531	6.20	80	
Exercised (unaudited)		(133)	3.58		